The New FASB Rules
Introduction and Background

**James Kroeker**
Vice-Chair
Financial Standards Accounting Board
Norwalk, Connecticut

**Christa LaBrosse**
Partner
Plante Moran PLLC
Southfield, Michigan

**Lee Plave**
Partner
Plave Koch PLC
Reston, Virginia
The Core Principle and 5 Step Model

The core principle:

*Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.*
The Core Principle and 5 Step Model

To achieve an outcome in alignment with the core principle, apply the 5 step model:

1. Identify the **contract** with the customer
2. Identify the **separate performance obligations** in the contract
3. Determine the **transaction price**
4. **Allocate the transaction price** to the separate performance obligations
5. **Recognize revenue** when (or as) each performance obligation is satisfied
5 Step Model

Step One: Identify the contract with the customer

• Define the contract
• Consider the probability of collecting the amounts in the contract
• Provide guidance on how to treat multiple contracts entered into at or near the same time and contract modifications
5 Step Model

Step Two – Identify the separate performance obligations in the contract

- Define each performance obligation
- Is it separate from the grant of the “symbolic IP license?”
- Examples include:
  - Training
  - Site selection
  - A&C / equipment set-up
  - Sale of equipment
5 Step Model

**Step Three – Determine the transaction price**

- Define the transaction price
- Should company include **both** initial franchise fee **and** anticipated royalties over time?
  - FASB – no: sales and usage-based royalties exception
  - Typically would only count initial fees
5 Step Model

Step Four – Allocate the Transaction Price

- Are there multiple separate performance obligations?
- What is the value of each SPO?
  - “Adjusted mkt assessment” or stand-alone value (e.g., what would it cost the prospective FE to buy the item or service from third party?)
  - Expected cost-plus-margin value
  - Residual value - applicable to certain performance obligations, including the symbolic license in most circumstances
- What portion of each SPO is not tied into the symbolic IP license?
  - E.g., business training in general vs. training in the Acme-brand method
5 Step Model

Step Five – Recognize the Revenue As Performance Obligations are Satisfied

• For SPOs that are not tied to symbolic IP license (e.g., non-brand-specific training), recognize when SPO is substantially completed

• For SPOs that are tied to the IP license (e.g., brand-specific training that can only be used together with exercise of IP rights), recognize over life of the F/A

• For portion attributable to grant of IP license, recognize over life of the F/A
Additional Discussion Points

on how the new revenue recognition rules will impact franchisors
1. So far, when publicly-traded FRs have adopted ASC 606, many do not appear to have identified SPO’s related to FR-provided initial services.

At the FASB’s Nov. 29, 2017 open meeting (as well as the text of 606), the Board made clear that it is appropriate to recognize the SPO’s that a FR performs at the start of a FE’s operation – and allocate an appropriate portion of the initial franchise fee applying proper review. What should we make of the approach taken thus far by public company FR's?
2. If many publicly-traded FR's have not allocated revenue to SPO's, is there concern that non-public FR's will simply follow suit, perhaps to save time in implementation, without performing the appropriate analysis?
3. In step 4, are there circumstances where an allocation method different than the residual approach would be appropriate for determining the portion of the initial fee to allocate to the symbolic IP license?
4. If a FR determines that its non-brand specific training provided to a FE is an SPO, can the FR estimate the stand-alone value of that training on the basis of value to a prototypical FE, not the specific individual who is being trained?
5. Is it proper to estimate the stand-alone value of training at the cost to obtain similar training from a business school, college, or other such institution?
6. What would be the proper way to undertake a cost-plus-margin analysis of providing an SPO to a new FE?
7. If a FR chose to re-write its franchise agreement to break its initial fee down into components (e.g., $X for training, $Y for site selection services, $Z for equipment design and layout, etc.), would that itemization be seen as a credible way to allocate value (leaving aside the brand-specific vs non-brand-specific issues)?
Many FR's set the initial franchise fee at an amount to cover the costs associated with performing the initial services. The deferral of a portion of the franchise fee will negatively affect net income in years when the FR is growing, due to the deferral of the revenue and immediate recognition of most expenses associated with the initial services. Is this an unintended result of the standard setting process?
9. What advice do you have for FR's that may face escrow requirements in registration states due to their financial ratios and net worth being negatively impacted as a result of applying the standard?
Thank You